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The Conference Board

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Economic Times

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Editor's Note:

Our main focus this month is the great budget buffoonery of 1990. This includes reactions from our Colloquium panel on the next page, a lively collection of quotes, etc., on pages 6 and 7, and even the wisecrack of the month at the bottom of this column. In addition, Henry Aaron's (no, not the baseball hero!) ideas about the economic policy needs of the country, longer run, put a good bit of emphasis on the budget, too. Finally, we get some insightful good news from Ben Wattenberg on page 8.

Ed Fiedler

Maxim of the month:

The four fundamental principles of American finance —

- **we want everything,**
- **we want it now,**
- **we want it for free,**
- **and if we discover that it isn't free we want someone else to pay for it.**

Mark Halprin, *Wall Street Journal*, October 23, 1990

How Bad?

Now that Washington has finished (for now) with the budget, the central economic question is recession, yes or no. At the moment it's still a close call, with almost as many statistical series saying no recession — most important, consumer spending, including automobiles, which, as a big ticket item, should be especially vulnerable in the present environment — as there are series with behavior that is consistent with recession. The guess here (this week!) is recession, but we'll have to wait and see.

In the end, however, this issue deserves less attention than it's been getting. Recession or no recession, the economy is in for a period of considerable weakness. It will be, as Al Sommers puts it, a long, tough workout.

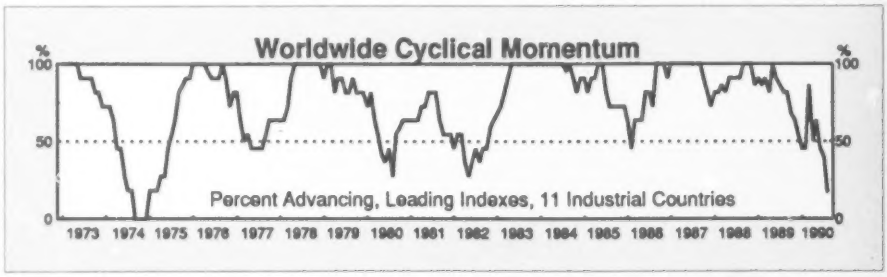
The more important question is: How much weakness and for how long? And subsequently, how vigorous a recovery? Here, again, there are good arguments on both sides. It is, for example, difficult to be pessimistic when the inventory overhang in the economy is minimal. Yes, inventories will decline, as always. But how much additional weakness will the economy experience because inventories have been overbuilt? At present all signs say very little.

Similarly, it is difficult to be pessimistic when profit margins seem to be holding up pretty well. Further, it is difficult to be pessimistic with the low dollar making U.S. producers highly competitive in world markets.

On the other side, we find that the cyclical weakness is global in scope, as shown in Geof Moore's chart below. As he has observed, one factor that distinguishes serious recessions from mere slowdowns is that serious recessions are international in scope. More worrisome is the troubled U.S. financial system, which could easily postpone or retard an economic recovery.

Thus it is not at all clear how long and difficult a spell the economy will have to live through. If this does prove to be a recession we're in now, my guess would be that in the end its dimensions will resemble the eight recessions since World War II. As a rough rule of thumb, this would involve an economic contraction lasting between six and sixteen months, a 1 to 5 percent decline in real GNP, and unemployment climbing to between 7 1/2 and 9 1/2 percent. Within that range, my bet is for a shallow decline and a subdued recovery.

This approach does not make for precise forecasts. Nevertheless, the history tells us two useful things: First, although recessions are not all alike, there is something of a family resemblance among them. Second, for the economy as a whole, the distress created by a recession is harsh but not unbearable. It will leave few if any pleasant memories, but we will survive it.



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Colloquium

Background:

The recently completed budget bill is highly controversial, among economists as well as politicians. Some don't want to reduce the deficit. Some like the idea of cutting the deficit just fine, but not how it's being done. Some think there's still a lot of blue smoke and mirrors in the promised cuts. And others think, all things considered, that it's a highly satisfactory compromise.

Question:

How comfortable are you with this budget legislation? Will it achieve its five-year $500 billion goal? Will it help the economy?

John T. Dunlop
Harvard University

Comfort is not an estate known to economists. The budget legislation is all we've got; it is better than the indefinite continuation of impasse. But it is not great. Much depends on the reactions of the financial markets and the Fed which should reward the effort liberally in this recessionary climate. Longer term the spending-control provisions that the bill gives to the President to deal with legislated excesses in broad categories may be more significant.

Albert M. Wojnilower
First Boston Corporation

The new budget properly leaves the probable deficits for 1991 and 1992 (excluding deposit-insurance costs) about where they've already been for four years. Higher taxes on the rich and for Medicare are appropriate, but the higher sales taxes will be more trouble collecting (and to the cost of living) than they are worth. With many financial institutions in desperate straits, counting on private credit growth to countervail a reduced budget deficit would have been suicidal.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charls E. Walker, Chairman, Charls E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Stephen H. Axilrod
Nikko Securities International

I'm fairly comfortable with the legislation. It begins to address the nation's structural savings deficiency and ends the Gramm-Rudman farces, but more will need to be done. Private savings rates remain disappointingly low, and the budgetary savings will certainly not be as large as currently promised. From a cyclical perspective, the package comes several years late, with the effect that the Fed is left with the full burden of stimulating economic recovery before it can be sure inflation is under control.

Charls E. Walker
Charls E. Walker Associates, Inc.

The budget agreement fails to confront the American voter's preference for low taxes and high government spending that is the fundamental fiscal problem in our increasingly plebiscite democracy. The agreement should have more strongly curtailed entitlement growth, vastly improved the President's powers to restrain a spending-prone Congress, and supplemented our highly unpopular income and payroll taxes (which now provide 90 percent of Federal revenues) with a "less unpopular" revenue-potent VAT.

U.S. Economic Policies for the Nineties

By Henry J. Aaron

The proud achievements of the preceding four decades cannot obscure a growing sense that the United States is faltering.

The United States faces nagging problems whose solutions require immediate and tangible sacrifice but offer deferred and diffuse benefits. From such burdens leaders in the White House and Congress can easily shrink.

The last decade of the American century has begun. The United States that emerged from World War II produced nearly half of world output and enjoyed uncontested military superiority because of its monopoly of nuclear weapons. It helped restore the economies of Western European countries devastated by war. It nurtured multilateral free trade to the benefit of all. It rearmed to neutralize military threats in Asia and Europe. For four decades the United States stood as the bulwark of the NATO alliance. And as the decade of the nineties begins, that military and diplomatic resolve has been rewarded by political and economic reform in once-hostile tyrannies around the world.

At home, World War II called forth the highest output that this or any other nation had seen. Three subsequent decades of rapid growth surpassed even that achievement. Until the 1970s, inequality fell as incomes rose. The long struggle for simple justice overthrew legal barriers to equal participation in American life by minorities, most notably African-Americans.

But as this new decade begins, the proud achievements of the preceding four decades cannot obscure a growing sense that the United States is faltering. The United States is paralyzed by a psychosis of poverty and helplessness in the face of problems at home and abroad. Possessor of the largest and deepest capital stock in the world, its saving rate is lower than that of any other developed country and less than half its own rate during the first three postwar decades. Beneficiary for decades of a system of free trade, it now quails before economic competition and flirts with proposals to undermine free international markets. World pioneer of mass public education, its students now perform worse than those of virtually all other countries for which data are available. Underwriter of the world's most costly health care system, it leaves more than 31 million people uninsured and millions more inadequately covered or at risk of losing coverage. Richer than ever before, it has found no way to reduce the significant fraction of its population that is poor, a fraction that remains larger than that of other industrial nations with lower average incomes. Victor in the cold war, its response to pleas from the countries of Central America and Eastern Europe for help in rebuilding economies ravaged by central planners is to agonize over how to shift monies within an already shrunken foreign aid budget.

President Bush stated in his first inaugural address, "We have more will than wallet." But the United States is a nation blessed with the highest per capita income of any developed country in the world. Its national product is two and a half times larger than that of the second largest economy. It is enjoying its longest peacetime expansion. The question is not whether America has enough wallet, but whether it has the will to use its abundant wealth to solve the problems that it faces.

The United States faces no imminent crises that demand decisive leadership. It confronts neither lethal threat from abroad nor economic crisis at home. Rather it faces nagging problems whose solutions require immediate and tangible sacrifice but offer deferred and diffuse benefits. From such burdens leaders in the White House and Congress can easily shrink. The nation can muddle through without absolute decline. Yet Americans cannot escape the reality that decisions taken during this decade will

determine whether the chronicle of growth at home and influence abroad continues or flags.

Each January since the early 1980s Congress has convened under the shadow of large and damaging deficits. Late in the month presidents have transmitted to Congress budgets typically based on overly optimistic economic assumptions. All have called for large cuts in domestic expenditures. Most have called for a few small tax increases, usually camouflaged. Most have used such ploys as asset sales to hide the deficit's true size. In the months that follow, members of Congress find they cannot agree on honest expenditure cuts or tax increases that will meet the official deficit reduction targets. And so they fashion, sometimes alone and sometimes with the aid of the administration, quaint and curious budgetary evasions. In the end, Congress adjourns after certifying compliance with the deficit reduction targets, when in fact little or no progress has been made.

The United States is avoiding national priorities rather than setting them, jeopardizing future success at home and abroad — economically, socially, diplomatically, and militarily. Earnings per worker have not grown for more than fifteen years, and the distribution of income has become markedly less equal. Growth of productivity is depressed. American businesses are losing competitive ground abroad. In the age of media hype, everyone has become jaded by exaggeration. But it is no exaggeration to say that what is done about national saving, investment, research, education, and health will determine whether America chooses excellence or mediocrity.

The overriding message can be simply stated. The United States remains rich and strong. Its richness and strength reflect an inheritance from nature and from past generations of Americans: a temperate climate, abundant resources, public institutions supportive of growth, and most of all an environment that rewards hard work, skills and innovation. These are not immutable gifts. The United States can sustain and build upon its inheritance, but only if it cuts short its national consumption binge, spends its wealth sensibly, and responds with imagination to the opportunities and challenges that are emerging at home and abroad.

Three themes echo loudly: One is that important progress can be made on some of America's problems — education, transportation, and the global environment — without spending large additional sums if the nation is willing to reform several current policies. Highway and airport congestion, for example, can be improved by changes in usage fees and by changing the way these facilities are built.

While the deficit has lost its capacity to shock, it has not lost its power to damage the economy by diverting roughly half of private saving from productive investments at home or abroad.

Second, traditional modes of addressing certain national problems must give way to new ones. In education, for example, without fundamental changes in the way schools are managed and in the criteria on which they are judged, more money is almost sure to be spent to little effect. And in international commerce, although free trade still promises enormous benefits, government intervention — to support research, to facilitate cooperation among domestic companies, or to penalize the anticompetitive behavior of other countries —may be required to sustain free trade.

Third — and perhaps the theme that echoes loudest of all — the fiscal mismanagement of the United States must end. Until the President and Congress take the necessary actions, progress on many national priorities will be hamstrung.

That the government finances of the United States are being mismanaged is not exactly breaking news. The federal deficit has been around long enough to seem normal — and boring. While the deficit has lost its capacity to shock, it has not lost its power to damage the economy by diverting roughly half of private saving from productive investments at home or abroad. Had the federal deficit risen because of a sharp increase in public investment, it would pose much less of a problem. In fact, net investment by the government has fallen. If private saving had risen, increased federal borrowing might have been harmless; however, net private saving in the 1980s fell to less than half the rate of the preceding three decades. The United States is in the midst of an extended consumption binge. Current national saving barely exceeds the annual depreciation of the existing stock of capital goods. Depressed saving slows growth of worker productivity. It is conventional wisdom that because of the deficit the United States cannot afford to solve serious problems of health care, education, and infrastructure. In fact, failure to attack these problems and the deficit simultaneously stems from a deeper common source: American leaders have been unwilling or unable to try to persuade the people of the need to cut spending, to raise taxes, or to take other controversial actions.

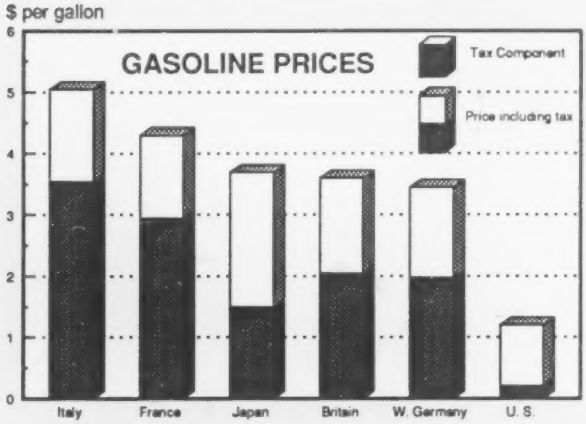
America's problems threaten no crises. They are hard for a democracy to solve, for they require that its citizens, most of whom are prosperous, make current sacrifices for long-term gains. They require that people unaccustomed to failure forsake old ways of thinking for new ones. The task of mobilizing the American people to deal with such problems and persuading them to do what needs to be done calls for both skill and courage.

Excerpted from *Setting National Priorities — Policies for the Nineties*, Henry J. Aaron, Editor, 1990, The Brookings Institution, Washington, D.C.

Perspectives On

The budget problem begins with the people. Congress is relatively representative of the people and the answer Congress typically hears, when it asks what programs should be cut, is foreign aid, welfare and your salary. Congress panders to the popular notion that although deficits are a bad thing they are always the fault of somebody else — a welfare mother, a militarist, a road builder, etc. Because the public does not insist its representatives attack the deficit in a systematic way, it is easier for Congress to continue responding to constituency groups interested in particular programs, groups whose support at election time is always more important than those with a generalized concern about unbalanced budgets.

Retiring Minnesota Congressman **Bill Frenzel**, September 18, 1990.



Source: American Petroleum Institute

Other countries must find our fussing about a nickel a gallon highly amusing!

Not one discretionary domestic program was eliminated — not Amtrak, not the Small Business Administration, not art subsidies. *Not one*. Everything is apparently essential.

Robert J. Samuelson, *Newsweek*, October 15, 1990.

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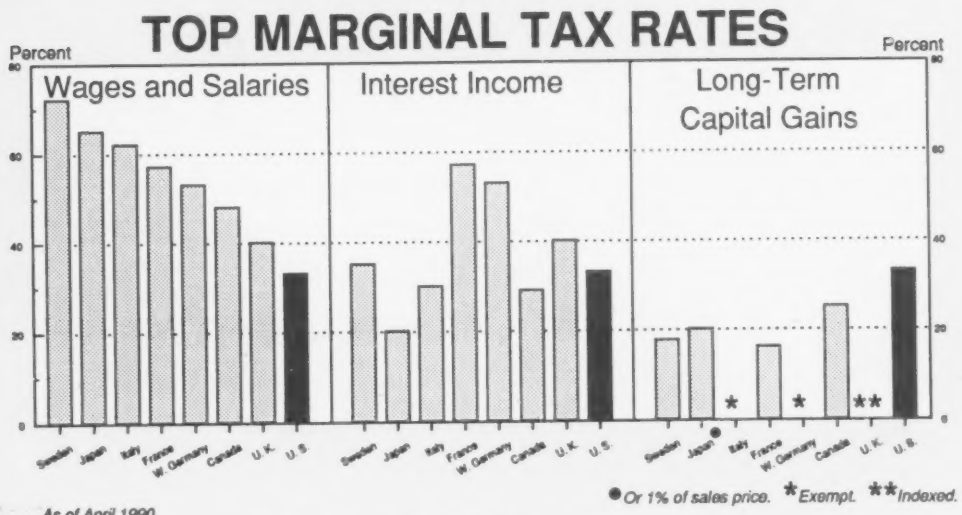
The Budget Brouhaha



As of April 1990.
Compiled by American Council for Capital Formation Center for Policy Research.

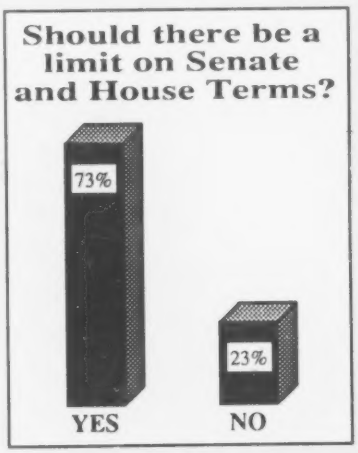
Until the recent change, the U.S. was the only country to apply the same top tax rate to wages and salaries, interest income, and capital gains. That helps to constrain the tax-shelter business, but it also misses the opportunity to offer a little extra incentive for saving and investment that other countries provide.

Over time, the top marginal income tax rate in the United States has come down significantly from 91 percent in the 1950s...it was reduced to 70 percent by the 1964 tax cut...to 50 percent [in] 1981...as a result of the 1986 tax reform...[to] 33 percent. Although a few people call for even lower rates, the United States has clearly come a long way in the pursuit of economic efficiency for higher-income groups.

Rudy Penner, "Economic Growth" in *Challenge to Leadership*, Urban Institute Press, 1988, Washington, D.C.

A higher charge for the doctor-bill portion of Medicare is only one of many more steps along this road. Beneficiaries are getting $4 in medical care for every $1 they pay, with the taxpayer picking up the rest. More than 28 percent of the federal budget now goes for Medicare and social security. There is no hope, ever, of rationalizing federal finances without a significant contribution from the elderly.

Jane Bryant Quinn, *Newsweek*, October 22, 1990.



Newsweek poll, Oct. 11-12, 1990

Despite this strong sentiment, incumbents were reelected with monotonous regularity.

As part of its $52.2 billion spending bill on farming, nutrition and rural development, Congress has voted half a million dollars to renovate the birthplace of retired band leader Lawrence Welk and build tourist accommodations nearby.

Associated Press, as reported in the *New York Times*, October 23, 1990.

Ready on Deck

By Ben J. Wattenberg

In theory, everything should be going wrong for the U.S. Navy. After all, our high-tech ships, now in the Middle East, are being manned by the crisis cohort of the American population. Many of them are the alleged children of chaos: minorities, broken homes, high-school dropouts, or graduates from schools that don't teach much.

We supposedly know all about them: They can't read well, write well, or do math well. They can't find Brazil on a map. Of course, they can't compete with those Japanese and German youths.

And yet, there they are on the flight deck of the carrier Independence, near the Straits of Hormuz, doing what they're supposed to be doing. TV shots of these "dumb kids" at work show them at some of the everyday tasks of the modern Navy: with radar, sonar, radios, consoles, and keeping up the electronic guidance systems in an environment choking with fine desert sands. Many of these clucks are working 16- and 20-hour days. In the engine room, the temperature can get up to 140 degrees.

Too bad. Uncompetitive.

Capt. James Stark, now at the Pentagon, recently commanded the guided missile cruiser USS Leahy in the Persian Gulf. "These are typically blue-collar, middle-class, middle-American kids," he says. "They've joined the Navy to see the world, or learn a trade, or for patriotic reasons, or to get away from home, or from girlfriends. A lot of them have problems. In high school, the way to be one of the guys was to screw up."

But not so in the Navy, says Capt. Stark: "On a ship if they screw up, the guys turn against them...They're great. We have the best Navy ever. They didn't come into the Navy to stay out of an Army draft, the way it was before the all-volunteer service."

Somebody else has noticed. Soviet Marshal Sergei Akhromeyev recently visited U.S. military bases. After watching U.S. enlisted men, in their crisp dress, yes-sirring everything that moved, telling him they were in service to defend their country, and then go tooling off in a red convertible, Marshal Akhromeyev said, "I wish I had people like that in my army."

Marshal Akhromeyev: "I wish I had people like that in my army."

The Navy today is 21 percent black, 11 percent Hispanic, and with plenty of others. On the Leahy, there were Filipino, Korean, Vietnamese, Samoan, Jordanian, and — hah! — Iraqi sailors. Capt. Stark says they get along pretty well.

Discipline and TLC.

The Navy does some things our high schools don't do. There are spot drug tests. Flunk the test and you're out of there. If recruits don't hack it on ship, out of there.

But there is also some Tender Loving Care. "There's more TLC," says Cmdr. Jo Dee Jacob, the Navy Fellow at the American Enterprise Institute. "A lot of these guys never had anyone to go to," she says. "Now, their chief, as tough as he might be, often becomes a father figure when they have problems."

Is this mostly navy propaganda? Perhaps. There are problems. But there are also some facts to face. The ships are advanced machines. The crew isn't from the Ivy League. The ships work.

Obviously, it can't work: low-tech kids in high-tech jobs. Hasn't the Navy been to all the double-dome seminars? Haven't they heard that we're not going to be able to fill the high-ed slots in the future, because our children aren't educated?

After boot camp, most of these sailors are in technical schools for three months to one year. On some Navy ships today, there are civilian college professors. Between shifts, many sailors study American history, foreign languages, math, English, and writing.

Sounds great. Is this mostly navy propaganda? Perhaps. There are problems. But there are also some facts to face. The ships are advanced machines. The crew isn't from the Ivy League. The ships work.

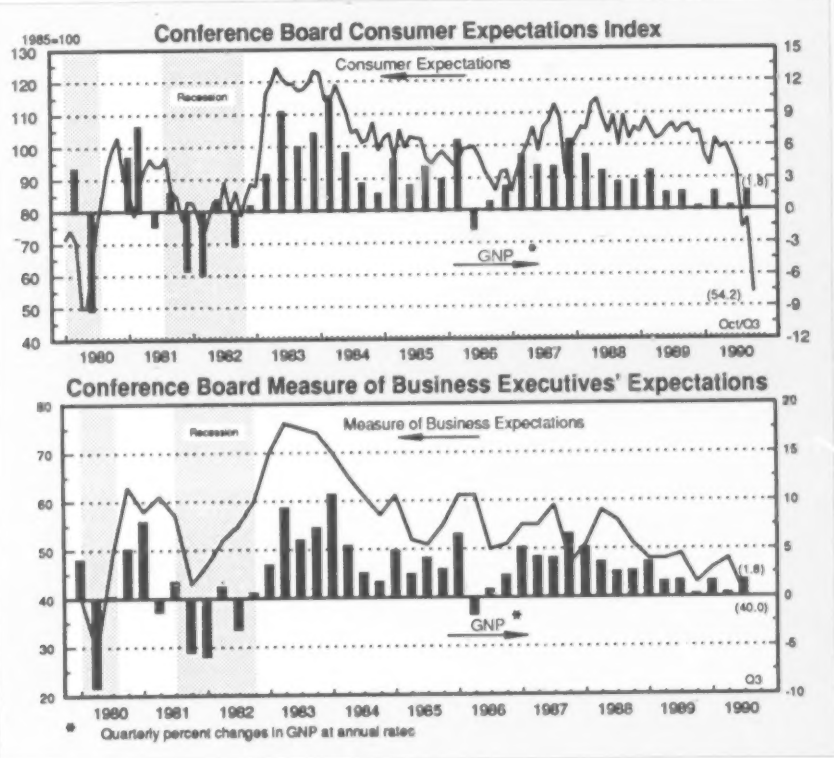
Whatever it was our terrible high schools did to these kids doesn't seem to be permanent. They can stay the course.

(Excerpted from the *Washington Times*, August 22, 1990. Ben J. Wattenberg is a senior fellow at the American Enterprise Institute.)

Conference Board Stat File

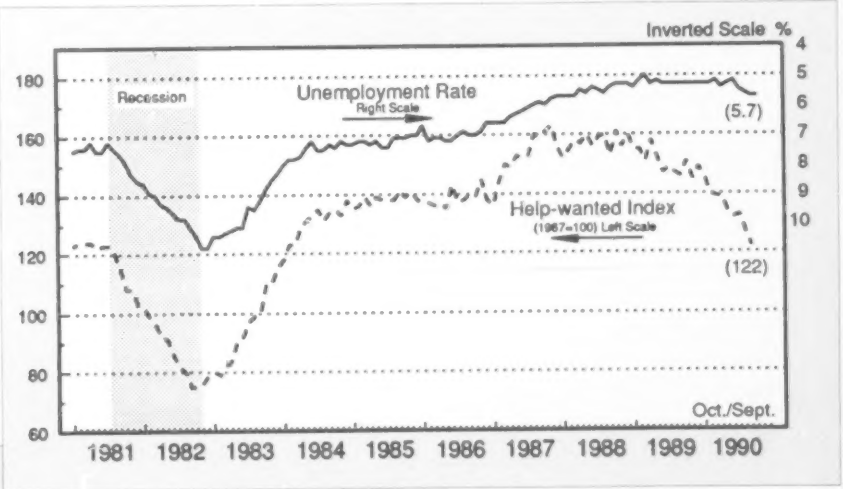
The spectacular plunge in consumer sentiment coupled with the sharp drop in help-wanted advertising signals severe business-cycle weakness. In neither case, however, has the signal been confirmed by a drop in economic activity. Spending by consumers, despite their worries, is holding up well. And unemployment has increased only a fraction of what the help-wanted index suggests. Perhaps it's only a matter of waiting for the other shoe to drop, but thus far the widely expected recession is still a forecast, not a reality. *(Note: Data for Conference Board series in this section are available upon request from Ken Goldstein at 212-339 0331.)*

Confidence



Consumer expectations have been battered by recent events.

Help-wanted Advertising and Unemployment



Labor demand falling sharply.

Conference Board Stat File

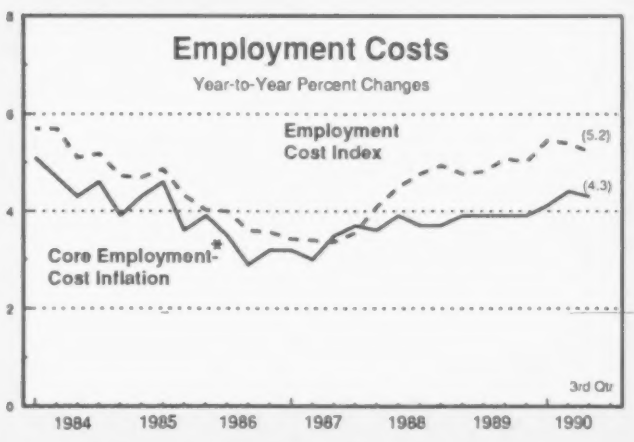
Indexes of Economic Momentum

Two of the three momentum indicators have dropped just below the neutral line.

Still shows a tendency toward acceleration.

Inflation Fundamentals

* Core inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI)

Inside the Crystal Ball

		UCLA	MERRILL L.	DU PONT	GEORGIA ST.	CONF. BOARD	L.H. MEYER	DRI	WEFA		
Date of Forecast		Oct.	Oct.	Oct.	Oct.	Oct.	Oct.	Oct.	Oct.		
Gross National Product											
(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)											
		%	%	%	%	%	%	%	%		
Actual	1990 1Q	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1Q 1990	Actual
	2Q	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	2Q	
Forecast	3Q	0.7	0.7	0.1	0.1	1.8	0.7	1.6	1.1	3Q	Forecast
	4Q	-3.0	-2.0	-1.0	-2.0	1.1	-2.3	-1.3	-1.1	4Q	
	1991 1Q	-3.1	-1.6	0.0	-1.3	2.0	-2.5	0.1	-0.6	1Q 1991	
	2Q	2.5	0.4	-1.0	-0.9	1.5	-0.6	0.8	1.2	2Q	
	3Q	6.8	2.6	0.5	0.9	1.8	2.0	2.4	1.9	3Q	
	4Q	6.0	2.9	2.9	2.5	2.0	2.8	2.7	1.9	4Q	
	1992 1Q	2.9		4.0		3.5	3.5	3.7	2.6	1Q 1992	
	2Q	1.6		4.0		2.5	4.0	3.3	2.5	2Q	
	3Q									3Q	
Inflation (GNP Deflator)											
(Percent change from same quarter one year earlier)											
Actual	1989 4Q	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	1989 4Q	Actual
Forecast	1990 4Q	5.6	4.9	5.2	5.2	4.9	5.0	4.1	4.3	1990 4Q	Forecast
	1991 4Q	3.5	4.2	4.6	4.5	4.8	4.1	3.7	5.2	1991 4Q	
Unemployment Rate											
(Percent, quarterly)											
Actual	1990 1Q	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	1Q 1990	Actual
	2Q	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	2Q	
Forecast	3Q	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	3Q	Forecast
	4Q	6.0	5.9	5.9	5.9	6.0	6.0	5.9	6.0	4Q	
	1991 1Q	6.7	6.3	6.0	6.2	5.8	6.4	6.2	6.4	1Q 1991	
	2Q	6.9	6.6	6.2	6.6	5.8	6.8	6.4	6.7	2Q	
	3Q	6.6	6.8	6.2	6.7	5.8	7.0	6.4	6.8	3Q	
	4Q	6.1	6.8	6.0	6.7	5.8	7.1	6.4	6.9	4Q	
	1992 1Q	5.8		5.9		5.6	7.0	6.3	6.9	1Q 1992	
	2Q	5.5		5.8		5.5	6.8	6.2	6.8	2Q	
	3Q	5.3		5.7		5.5			6.7	3Q	

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